STATEMENT

ON

The Impact of Competition on the Telecommunications Industry

Presented by

Harvey Hollins, AARP Michigan Government Affairs

Before a

Roundtable Forum

Hosted by

Congressman John Conyers

Wayne State University
Detroit, MI

Good morning Congressman Conyers and invited members of Congress. My name is Harvey Hollins and I am the Government Affairs Representative for AARP Michigan. Thank you for allowing AARP the opportunity to weigh in on the issue of competition in the telecommunications industry. On behalf of the AARP membership in Michigan, we thank Congressman Conyers, not only for hosting this forum, but for his demonstrated advocacy on behalf of consumers regarding telecommunications and other issues.

TELECOMMUNICATION COMPETITION

Basic telephone service is essential for all people, particularly older people. Nonetheless, 9.8 percent of low-income, older households and 15.2 percent of all households with annual incomes below $10,000 do not have telephone service. Overall, about 5.6 percent of US households do not have telephone service.

In recent years, competition and advances in technology have changed the way people communicate and transformed the single-service telephone industry into a multi-service telecommunications industry. Now, in addition to plain old telephone service, consumers can subscribe to Internet access plans and services such as call waiting, call forwarding and caller ID. They can make calls from almost anyplace through a wireless telephone and transmit data, graphics or video over the Internet. For many of these services, consumers also can choose from a variety of vendors. During the transition to the current, more competitive telecommunications market, many regulators changed the way they oversaw telecommunications service providers. Under laws allowing for alternative forms of regulation, usually introduced at the request of local telephone companies, the state public service commission (PSC) is given discretion to reduce or eliminate regulation of certain telecommunications services or rates. Most states have implemented price-cap regulation, which is viewed as transitional regulation while the telecommunications industry moves from monopoly to competition. By breaking the link between the cost and price of service, price caps allow telephone companies to reap the financial rewards of greater efficiency.

Competition lies at the heart of the Telecommunications Act of 1996. The goal of this law was to bring the benefits of competition to consumers. In order for all consumers to realize the benefits intended by Congress, however, the Federal Communications Commission and state PSCs must ensure not only that service providers compete on a level playing field but that companies will provide better service quality, reliability and fair choices for all customers at just, reasonable and affordable rates.

The principal objective of the Telecommunications Act of 1996 was to bring competition to the marketplace for all telecommunications services. An important element of this arrangement was the 14-point competitive checklist, a list of conditions that the regional Bell operating companies (RBOCs) must satisfy in order to be allowed to provide long-distance service to their local customers. In adopting the checklist Congress sought to ensure that real competition for local telephone service existed or would develop without hindrance before the RBOCs were allowed to enter the long-distance market. Proponents of the act envisioned that it would lead to an open, fully competitive telecommunications marketplace where companies would provide consumers with better service quality, more choices and lower prices. Six years after the act was signed into law, competition for local telephone service is seriously lacking. In fact, new competitors, also known as competitive local-exchange providers (CLECs), control just 8.5 percent of all the local telephone lines in the country and only 4.5 percent of the lines serving residential and small-business consumers. Enactment of the 1996 law also produced high expectations that the largest providers of local telephone service, the RBOCs, would move into each other's service territories and become major competitors. In reality, the RBOCs have chosen to merge or simply refrain from moving into the territory of another RBOC rather than compete. Prior to the act, the four largest providers of local telephone service owned 48 percent of all the telephone lines in the country. Today, they control 85 percent.

While some wireless or cellular telephone service providers are marketing wireless service as a competitive local-service alternative, the service is not yet a viable substitute for wire-line local telephone service and thus these providers are not competitors of local-service companies.

Federal and state regulators should deny applications from regional Bell operating companies to enter the long-distance markets within their regions until local competition is fully effective and market forces can replace regulation for all customers, that is, until the competitive checklist and public interest standard set out in the Telecommunications Act of 1996 are met.

Congress should require the FCC to enforce the most rigorous performance standards, data validation procedures and audit requirements necessary to ensure the regional Bell operating companies open their markets to competition. The Federal Communications Commission should substantially increase the penalties for regional Bell operating companies and their affiliates that fail to comply with market-opening requirements.

RESIDENTIAL RATE RESTRUCTURING

Citing the need to "rebalance" rates, the regional Bell operating companies (RBOCs) are determined to raise residential and rural rates for basic local service. The companies state that raising these rates will permit them to lower urban and business rates, a goal they say they must achieve if they are to survive in a competitive market. The RBOCs justify raising residential rates by arguing that in the past urban areas subsidized rural rates and businesses subsidized residential rates. However, state consumer advocates, AARP and some state public service commissions have successfully challenged these long-asserted positions.

In a number of recent regulatory decisions, state public service commissions have pointed out that the cost of the local loop-the wire and other infrastructure that connects the customer with the telephone company-is not solely attributable to basic local-exchange service. The local telephone network is a shared facility. Services in addition to basic local telephone service, such as call waiting, in-state long-distance service and Internet services, also bring in revenue. In short, the cost of the local telephone network, and by extension the cost of providing customer access, should not be assigned to one particular service as it is the mix of services provided that determines the cost. In this regard, when revenues for all services sold over telephone lines are taken into account, basic residential telephone service more than pays for itself.

State public utility commissions should protect residential and rural ratepayers by denying rate increases that would result from so-called rebalancing. In testing the existence of a subsidy to residential customers, state regulators should adopt the following guidelines:

- Determine which costs would be avoided if residential service were discontinued and business service were maintained. Do not fully allocate a particular cost to residential service if that cost would also be incurred in providing a network that only offered business service.
- Take into account that a substantial portion of telecommunications traffic is between business and residential customers, and thus the revenue from business services depends, in part, on residential service.
- Ensure that all assumptions regarding the cost of money, depreciation, and other cost inputs are reasonable and accurate.

ACCESS OR END USER COMMON LINE CHARGES

The Federal Communications Commission allows local telephone companies to include a subscriber line charge on local telephone bills. The agency states that the charge partially offsets the cost companies pay for building and maintaining the local telephone network. For most local telephone customers, the subscriber line charge rose from $3.50 a month to $4.35 in July 2000, and to $5 in July 2001. The charge increased to $6 in 2002 and is scheduled to increase to $7.00 this year.

These increases in the subscriber line charge are part of an FCC order that the commission contends adjusts service prices to reflect costs and thus establishes a pricing structure that is more consistent with competitive markets. The theory is that as telecommunications markets become increasingly deregulated, competitive pressures will force industry to price all individual products and services at their respective costs. In reality this justification of increased subscriber line charges is incompatible with competitive market behavior and ultimately detrimental to consumers.

Policymakers at both the federal and state level should adopt pricing structures that are observed in actual competitive markets. Rather than erecting high rate barriers that discourage customers from signing up for service, companies in competitive markets recover their costs in the bundles of products and services they sell over their networks.

It is with these criteria in mind that AARP supports the reduction, if not the outright elimination, of the state access charge or end-user common line charges (EUCL) in Michigan. The EUCL is assessed on local phone customers with the stated purpose of recovering the costs of the local network. AARP is concerned that this charge is imposed based on the outdated assumption that the local network is built and maintained just for voice services. Of course, this is not the case. In addition to providing basic local telephone service, the local network is increasingly operated and maintained to also provide non-voice advanced services such as DSL. In fact, the demand for non-voice services has become the driving force behind the evolution of the voice network into an integrated multi-service network. As such, basic local telephone service should only bear a portion of the cost of upgrading the network. We are concerned that basic local service, through the EUCL, currently is designed to collect 100 percent of the cost to upgrade the network.

AARP research shows that companies in more competitive industries, including US banking and wireless communications, rarely set their prices equal to the cost of each specific, stand-alone product. While the large local telephone companies argue that the contribution from the EUCL is required to cover their costs, experience in other more competitive markets indicates that companies rarely set their prices equal to the cost of production. Rather, they respond to competition by lowering or eliminating the price of customer access and then recouping this cost through the provision of multiple products and pricing options. They recognize that their firm's overall profitability is tied to the total profits generated from their customers and not necessarily to the profits created by a particular product or service. Further, the marketing departments of competitive firms understand that consumers want products and services that offer them value. Network access, divorced from network services, has no perceived value. Thus, consumers have no interest in purchasing network access as a standalone service. In this regard, telephone consumers have no use for, and would never buy a EUCL by itself.

In conclusion, the consumers of Michigan should benefit as the local telecommunications market in Michigan becomes increasingly more competitive. For this to happen, however, policy makers must be focused on ensuring the type of pricing structures that are observed in competitive markets. Things like the EUCL is inconsistent with competitive markets, in which firms do not erect high rate barriers that discourage customers from signing up for service. Policymakers should also ensure that basic local telephone service only bears a portion of the cost of upgrading the network.

Thank you.